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PRIME SOVEREIGN ESG RISK AND IMPACT RATINGS

NOVEMBER 2023

Introduction	3
Why Prime?	4
Prime sovereign ESG framework: An overview	5
In depth: how the Prime sovereign ESG frameworks aim to reflect key risks and impacts	6
How the Prime sovereign ESG frameworks generate risk and impact measures	8
How our flag process highlights new information	10
How Insight's portfolio managers and analysts use the Prime sovereign ESG risk and impact measures	11
Insight's responsible investment and fixed income credentials	13
Frequently asked questions	14

// The Prime sovereign ESG ratings aim to help us identify key risks for sovereign debt issuers, and their progress on ESG issues. In doing so, the ratings help us support a wide range of clients with specific objectives. //

COLM MCDONAGH, CHAIR OF SOVEREIGN FIXED INCOME RESPONSIBLE INVESTMENT IMPLEMENTATION GROUP



INTRODUCTION

Environmental, social and governance (ESG) factors have major implications for countries and their debt creditworthiness.

- **Environmental risks**, particularly climate change, can have a significant effect on a country's economic and political outlook.
- **Social factors**, such as human rights and demographic trends, can materially shift investors' perceptions.
- **Governance factors**, ranging from the quality of institutional frameworks to respect for rule of law, often have a material relationship with sovereign debt performance.

We have formalized our experience in analyzing ESG risks to generate measures of sovereign risk that we believe more reliably and accurately reflect material risks and alignment with broad ESG goals.



This led us to create the Prime sovereign ESG risk and impact frameworks, which aim to focus on the key ESG risks and sustainability issues respectively for sovereign debt investors.



Powered by Insight Investment

PRIME SOVEREIGN ESG RISK AND IMPACT RATINGS: KEY NUMBERS¹

126

The number of countries covered

90

ESG risk metrics

73

ESG impact metrics

¹ As of September 30, 2023.

WHY THE PRIME SOVEREIGN ESG RATINGS?

OVERCOMING INTEGRATION CHALLENGES FOR SOVEREIGN DEBT INVESTORS

We believe that ESG factors can be material, but the tools to identify and consider these issues are not well established and can be difficult to integrate within existing investment models. The Prime sovereign ESG ratings aim to help us build relevant ESG factors directly into the tools that inform our investment decisions.

HOW INSIGHT USES THE PRIME SOVEREIGN RATINGS

- **Identify risks and engagement topics:** The Prime sovereign ESG risk and impact ratings aim to help our sovereign analysts and portfolio managers consider material ESG risks in their investment decisions and to identify potential issues for constructive dialogue with sovereign debt issuers.
- **Create ESG-specific portfolios:** For clients seeking investment strategies that reflect their views on ESG issues, the Prime ratings enable us to construct dedicated solutions and portfolios with specific ESG criteria.



For more information on how Insight's managers and analysts use the Prime sovereign ESG risk and impact ratings, see page 11.

HOW THE PRIME SOVEREIGN RATINGS HELP INVESTORS

- Prime processes multiple metrics, with our analysts overlaying their expertise in seeking to ensure they reflect relevant and material risks that issuers face.
- We believe the Prime sovereign ESG risk ratings reflect high-quality information that is especially relevant for fixed income investors, as they aim to highlight what we believe to be the material risks investors most focus on and build in our analysts' qualitative judgement.
- By generating separate risk and impact ratings, we can tailor portfolios to client preferences, allowing for a greater focus on sustainability if required.
- The use and impact of our ESG ratings in specific investment strategies will vary, potentially significantly, depending on the nature of the strategy and the structure of the investment mandate involved.



For specific details on how we use Insight's Prime ratings in our investment solutions, please contact your Insight relationship manager.

PRIME SOVEREIGN ESG FRAMEWORKS

AN OVERVIEW

FOR OUR FOURTH-GENERATION SOVEREIGN ESG FRAMEWORK WE HAVE UPDATED OUR ESG RISK AND IMPACT APPROACHES WITH EXPANDED DATA SOURCES. THE RISK FRAMEWORK CONTINUES TO FOCUS ON ESG FACTORS THAT HAVE RELEVANCE TO SOVEREIGN CREDITWORTHINESS, WHILE THE IMPACT FRAMEWORK FOCUSES ON ESG FACTORS RELATED TO THE SUSTAINABLE DEVELOPMENT OF A COUNTRY.

The frameworks use data from numerous sources, carefully selected for quality, integrity and coverage, by Insight's Sovereign Fixed Income Responsible Investment Implementation Group.

Benefits of the Prime sovereign ESG frameworks

- Separate risk and impact measures allow for greater flexibility and application as a portfolio management tool.
- The measures can be used to tailor portfolios to client preferences, allowing for a focus on impact or sustainability as required.
- Our sovereign ESG flags aim to reflect ESG risks and impacts not reflected in quantitative data.

Figure 1: Prime sovereign ESG risk rating – integrating ESG factors

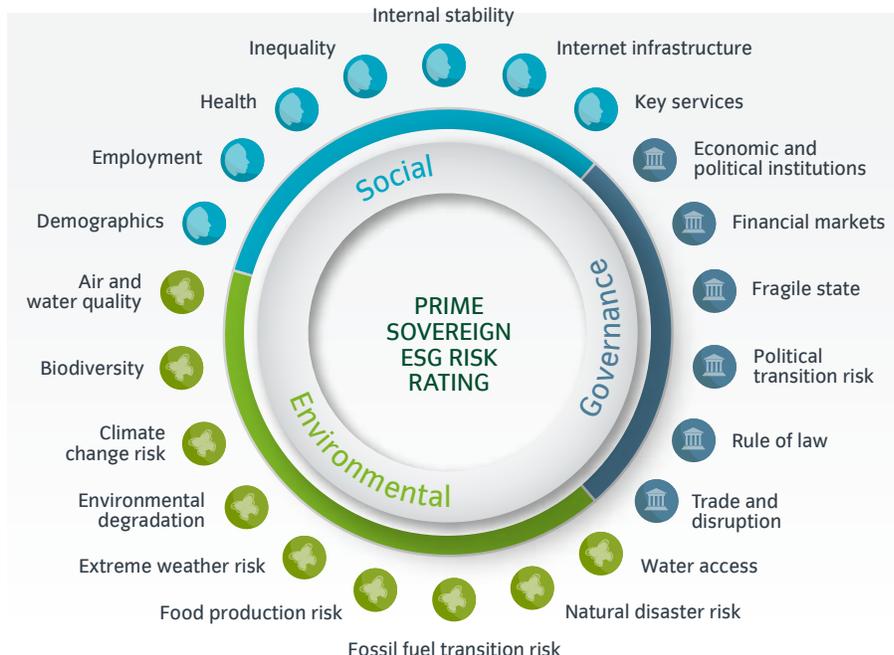
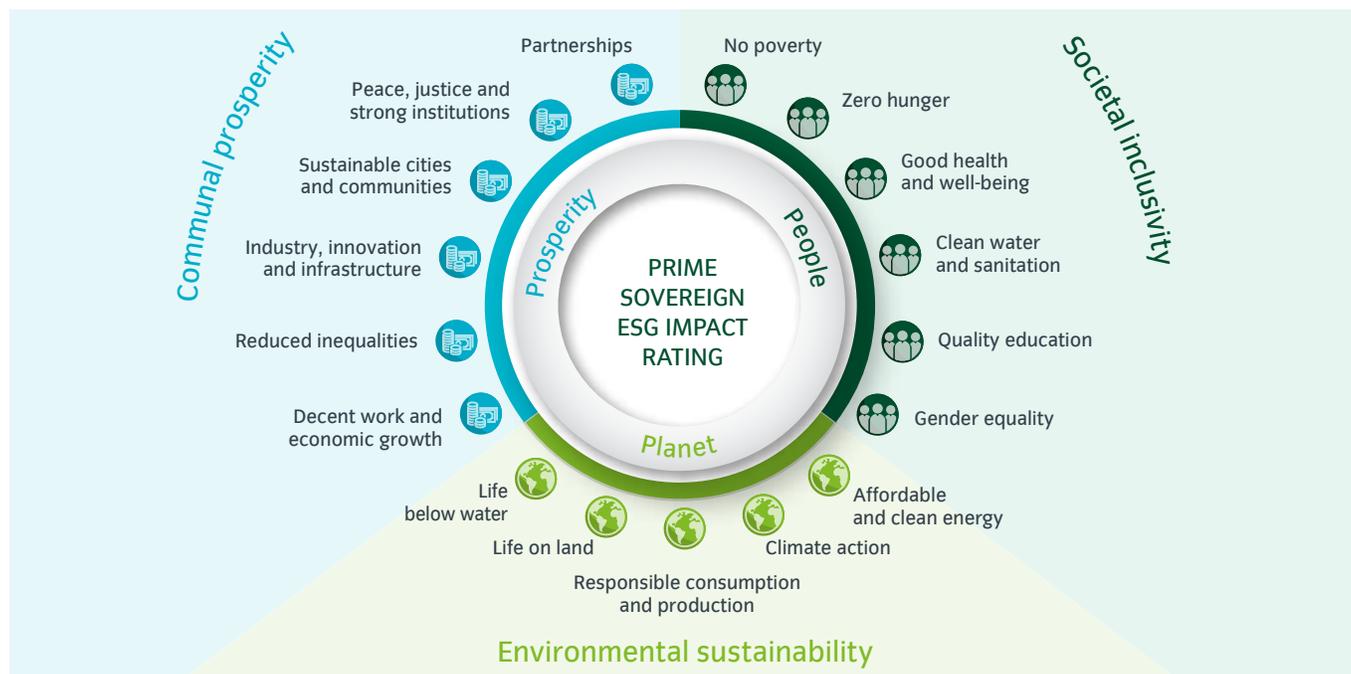


Figure 2: Prime sovereign impact rating – reflecting the 17 UN Sustainable Development Goals (SDGs)



IN DEPTH

HOW THE PRIME SOVEREIGN ESG FRAMEWORKS AIM TO REFLECT KEY RISKS AND IMPACTS

THE PRIME SOVEREIGN ESG RISK AND IMPACT FRAMEWORKS COVER 126 COUNTRIES DRAWING ON 90 RISK AND 73 IMPACT METRICS RESPECTIVELY – SOURCED FROM PUBLICLY AVAILABLE THIRD-PARTY DATA SOURCES, SUCH AS THE WORLD BANK OR V-DEM.

A CLOSER LOOK AT THE SOVEREIGN ESG RISK FRAMEWORK

The sovereign ESG risk framework generates a quantitative measure of a country’s exposure to and management of ESG risks. In shaping this fourth-generation framework, Insight reviewed more than 5,000 data series while undertaking an internal vetting process to assess the methodology, data providers’ independence, academic integrity and scope for bias. This helps with the aim of ensuring the data used is both high quality and impartial.

Inputs to the framework

The framework covers 126 countries and includes 90 metrics, covering a range of broad themes across the environment, social and governance pillars (see Figure 3).

Outputs from the framework

The framework generates two risk measures for each country: an overall ESG risk rating and an ESG risk momentum score. These are typically updated annually.

- The **overall ESG risk rating**, from 1 (best possible) to 5 (worst possible), provides a current snapshot of a country’s exposure to, and management of, ESG risks that may affect their overall creditworthiness.
- The **ESG risk momentum score**, on an open-ended scale, provides an indication of a country’s improvement or deterioration over a five-year period.

Figure 3: Sovereign ESG risk framework – how we assess ESG factors for sovereign investments



A CLOSER LOOK AT THE SOVEREIGN IMPACT FRAMEWORK

The Prime sovereign impact framework is aligned with the United Nations Sustainable Development Goals (SDGs). The SDGs are a collection of 17 goals agreed upon by UN member states in 2015 as a shared blueprint for peace and prosperity, for people and the planet. The aim is that these SDGs are achieved by 2030².

Insight has aligned our impact framework with the SDGs because they form an internationally recognized approach, with quantifiable targets that can be measured and evaluated, and that can provide a platform for qualitative engagement with issuers.

Inputs to the framework

Insight categorizes each SDG into 'people', 'planet' or 'prosperity' pillars. The framework covers 126 countries based on 73 metrics that have been screened for quality and suitability based on data coverage, relevance for impact and measurability.

Outputs from the framework

As with the risk framework, the impact framework generates two impact measures for each country: an overall ESG impact rating and an ESG impact momentum score:

- The **overall impact rating**, from A to E, provides a current snapshot of a country's progress with regard to ESG factors aligned with the UN SDGs. This rating can help to differentiate between those countries most likely to achieve the UN SDG targets, and those at risk of failing to do so.
- The **impact momentum score** provides an indication of a country's improvement or deterioration with regard to those ESG factors over a five-year period.

Figure 4: Sovereign impact framework – how we assess ESG factors for sovereign investments



² For more information: <https://sdgs.un.org/goals>

HOW THE PRIME SOVEREIGN ESG FRAMEWORKS GENERATE RISK AND IMPACT MEASURES

THE PRIME SOVEREIGN ESG SCORING METHODOLOGY FOLLOWS A TRANSPARENT AND ROBUST PROCESS TO GENERATE ESG RISK AND IMPACT MEASURES, GUIDED BY INSIGHT'S ANALYSTS TO REFLECT WHAT WE BELIEVE TO BE THE RELEVANT AND MATERIAL ESG RISKS AND IMPACT OPPORTUNITIES SOVEREIGNS FACE.

RAW DATA INPUT

Data inputs for the ESG risk and impact measures come in a variety of different formats. For example:

- **Bounded, continuous data set** – e.g. % of population with access to clean drinking water
- **Unbounded, continuous data set** – e.g. PM_{2.5} air pollution, mean annual exposure (micrograms per cubic meter)
- **Bounded, discrete data set** – e.g. strength of legal rights index, where 0= weak, 12 = strong

Data distribution varies between metric outputs. While some metrics were roughly normally distributed, many metrics exhibited either positive or negative skew. This is in situations where most countries score quite well, with a few countries scoring very poorly.

NORMALIZED METRIC SCORES

For both frameworks we screen data inputs using three criteria:

- 1 Data coverage:** We exclude data inputs with less than 70% coverage in the last five years
- 2 Data recency:** We exclude data inputs with most recent data points older than five years
- 3 Data relevance:** We exclude data inputs where the relation to ESG risk or impact is not clear

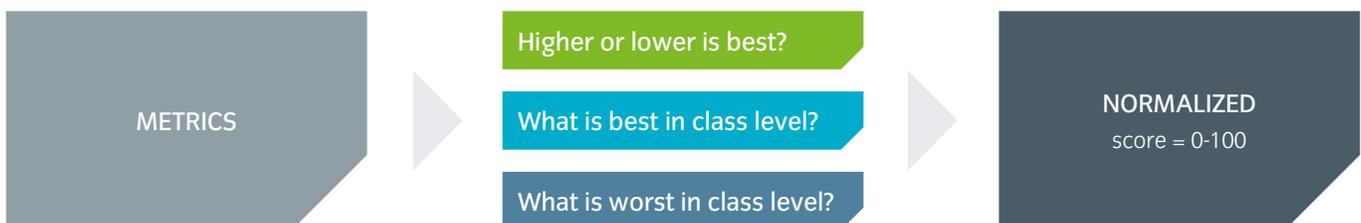
For the sovereign ESG risk framework, each of the 90 raw data inputs is assigned to one of the environmental, social and governance pillars.

For the sovereign ESG impact framework, each of the 73 raw data inputs is assigned to one of the 'people', 'planet' and 'prosperity' pillars.

We convert each raw data input into a standardized 0-100 scaled score, where 0 is the worst possible and 100 the best, based on three parameters (see Figure 5):

- 1 Is a higher or lower score more desirable?** For a metric such as prevalence of undernourishment a lower value is more desirable, while for access to clean fuels a higher value is more desirable.
- 2 What should the 'best in class' level be?** Each metric is capped at the 98th percentile to remove the impact of outliers, using a 10-year data horizon.
- 3 What should the 'worst in class' level be?** Each metric is floored at the 2nd percentile to remove the impact of outliers, using a 10-year data horizon.

Figure 5: Metric score calculation process



CALCULATING RISK AND IMPACT RATINGS

Risk framework: The normalized 90 metric scores are separated into the environmental, social and governance pillars and averaged to provide overall E, S and G scores. In order to calculate an overall ESG risk score we apply weights of 30%, 30% and 40% to the E, S and G pillars respectively.

Impact framework: The normalized 73 metric scores are assigned to one of the 'people', 'planet' and 'prosperity' pillars. The pillars are then averaged to provide an overall impact score.

Quintile buckets for simplicity

Once we have the overall normalized (0-100) scores for each country, we map these onto five buckets for simplicity. We divide the data using the mean, 0.5 and 1.5 standard deviations. For the **risk framework**, a scale of 1-5 is used, with bucket 1 including the top-performing countries and 5 the bottom-performing countries. **For the impact framework**, a scale of A-E is used, with bucket A including the top-performing countries and E the bottom-performing countries (see Figure 6).

Figure 6: Sovereign ESG risk and impact rating buckets

Sovereign risk framework		
Lower bound	Upper bound	ESG RISK RATING
0.00	47.36	5
47.36	59.16	4
59.16	70.97	3
70.97	82.77	2
82.77	100.00	1

Impact framework		
Lower bound	Upper bound	ESG IMPACT RATING
0.00	49.26	E
49.26	61.00	D
61.00	72.74	C
72.74	84.48	B
84.48	100.00	A

Momentum scores to indicate progress

Alongside the ESG ratings, we calculate momentum scores to determine a country's overall direction of travel, and whether the country is exhibiting improvement or deterioration through time. The momentum score is an exponentially weighted average of the improvement in a country's 0-100 ESG score over the last 5 years.

We use the following qualifiers to describe a country's direction of travel over time, depending on their momentum score. This can help to identify how countries' susceptibility to ESG risks evolves over time. These labels are determined with respect to standard deviations (s.d.) above or below the mean momentum score:

- <-1 s.d. 'broadly deteriorating'
- -1 to -0.1 s.d. 'some deterioration'
- -0.1 to 0.1 s.d. 'stable'
- 0.1 to 1 s.d. 'some improvement'
- >1 s.d. 'broadly improving'

HOW OUR FLAG PROCESS HIGHLIGHTS NEW INFORMATION

OUR SOVEREIGN FLAGS, INTRODUCED IN 2021, AIM TO HIGHLIGHT ESG RISKS AND IMPACTS THAT MAY NOT BE REFLECTED IN OUR QUANTITATIVE FRAMEWORKS.

Events may occur too quickly to be reflected in the underlying data used by our risk or impact ratings.

Insight’s sovereign analysts will initiate flag recommendations and seek approval from the Sovereign Fixed Income Responsible Investment Implementation Group (see Figure 7).

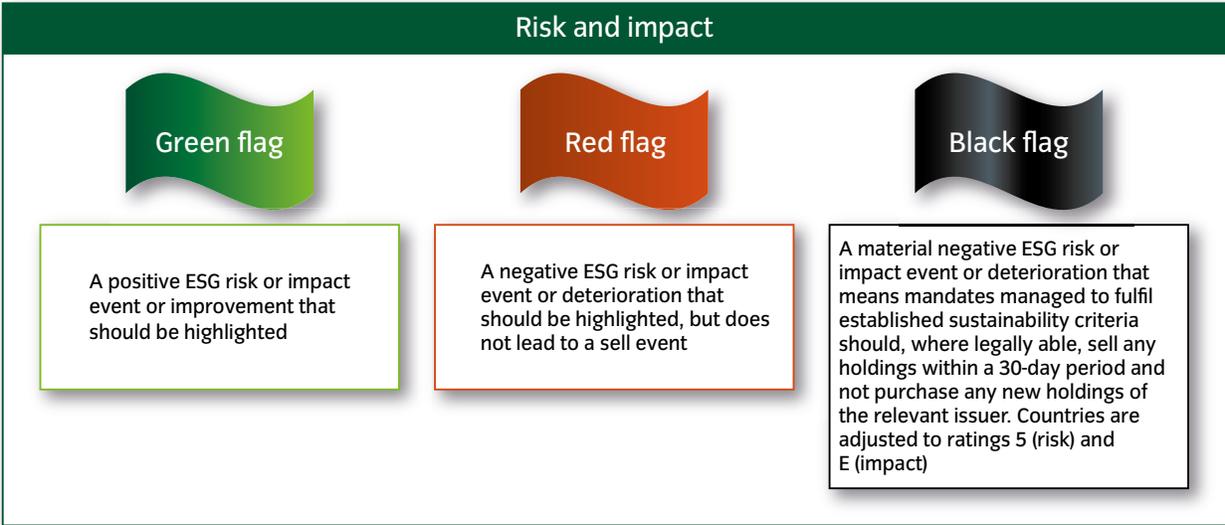
Black flags, which indicate a recommendation to sell securities for some strategies, alongside an immediate downgrade for a country’s risk and impact ratings to the worst possible rating,

are reviewed by Insight’s Ratings and Exclusions Group and the Responsible Investment Committee (RIC).

On approval from the RIC, the decision is communicated to Insight’s investment teams and reflected within relevant systems.

The Sovereign Fixed Income Responsible Investment Implementation Group regularly reviews all flags in place.

Figure 7: Insight’s flag recommendations⁴



CASE STUDY: HOW WE APPLIED THE FLAGS WHEN WAR BROKE OUT IN UKRAINE

The Sovereign Fixed Income Responsible Investment Implementation Group had been monitoring the situation in Russia and Ukraine for some time, and placed a red flag on the Russian sovereign on 2 February. The Russian invasion in late February led to a black flag being applied to the Russian sovereign, leading to an immediate downgrade of its Prime sovereign ESG risk rating to 5 and its impact rating to E, and specified mandates with ESG-related criteria were required to sell their holdings, where possible, within 30 days.

2 February 2022 
A 'Red Flag' was placed on the Russian sovereign to reflect the heightened tensions posed by the status of its military apparatus

25 February 2022 
A 'Black Flag' was placed on the Russian sovereign reflecting the land and air military action taking place within Ukraine



HOW INSIGHT'S PORTFOLIO MANAGERS AND ANALYSTS USE THE PRIME SOVEREIGN ESG RISK AND IMPACT MEASURES

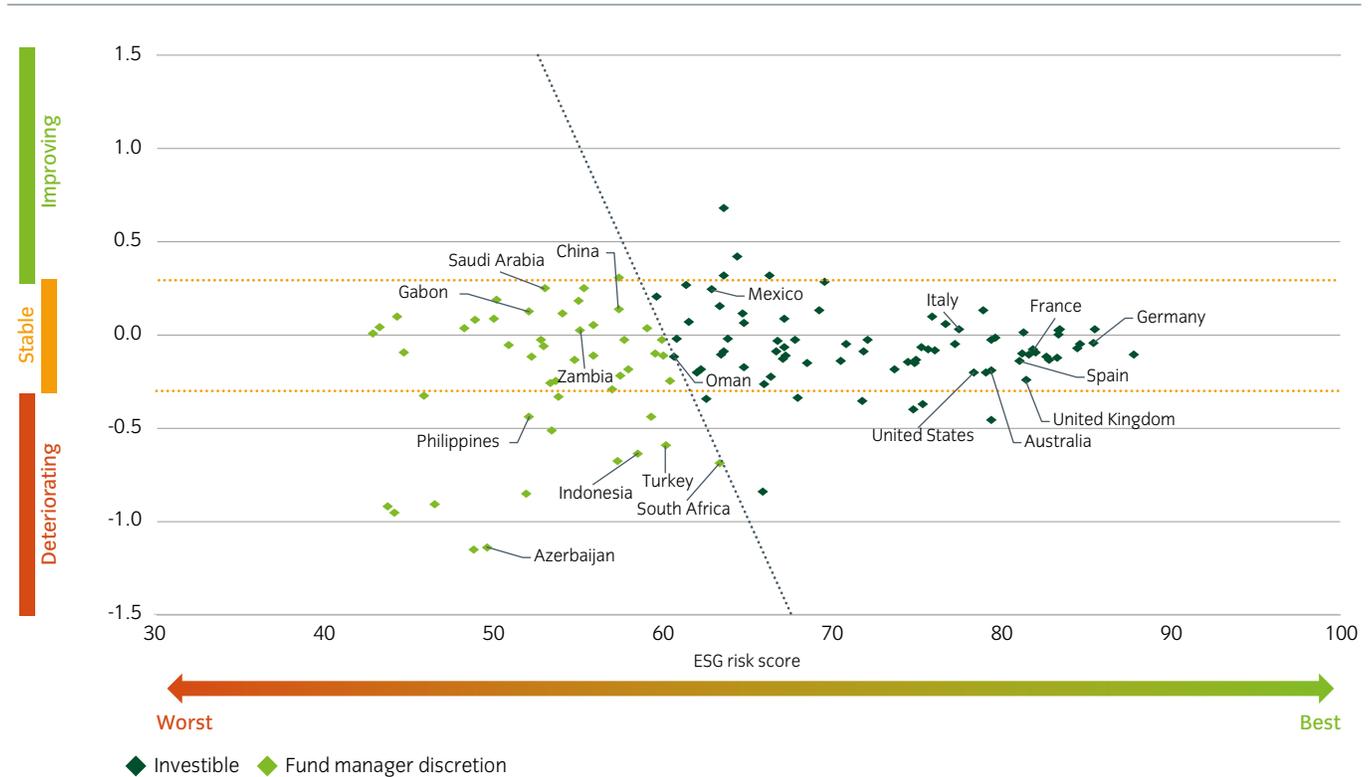
THE PRIME SOVEREIGN ESG RISK AND IMPACT RATINGS ARE INTENDED TO SUPPORT OUR RESEARCH AND ACTIVITY IN MANY WAYS.

- 1 To expand the scope of our existing risk models:** When making investment decisions regarding sovereign debt, and other related debt such as issues from state-owned enterprises where the sovereign is effectively the backing entity, identifying changes in economic conditions and the risk profile of the relevant country are key. ESG indicators can provide another angle on economic and other matters.
- 2 To guide the management of client-specific portfolios with ESG guidelines:** We manage strategies for clients that specify that the overall ESG rating of portfolio holdings must exceed (be better than) that of the relevant benchmark. The ratings enable us to exclude or focus on issuers according to their exposure to and management of ESG factors.
- 3 To support reporting to clients on ESG-specific factors:** The ratings enable the potential to demonstrate how sovereign debt portfolios perform from an ESG risk and impact perspective, either on a standalone basis or relative to a benchmark.
- 4 To indicate issues for dialogue:** Our ratings may be used to identify and prioritize matters to address with sovereign issuers.

RISK AND IMPACT MOMENTUM SCORE EXAMPLES

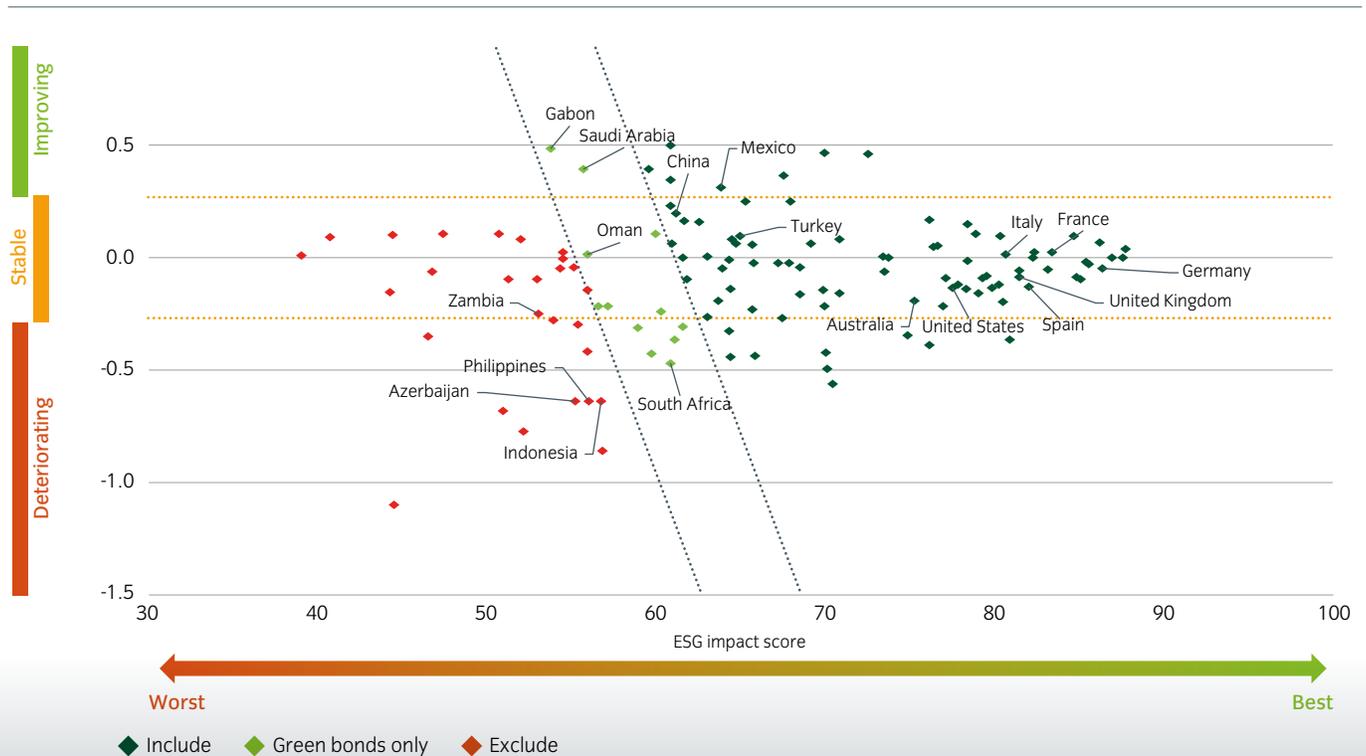
The raw sovereign ESG risk scores, which underlie the Prime ratings, can aid the sovereign credit evaluation process.

Figure 9: Sovereign ESG risk framework – risk score versus risk momentum score³



The raw sovereign ESG impact scores, which underlie the Prime impact ratings, can inform mandates with impact-focused guidelines and objectives. Sovereign issues may be excluded where they do not meet a mandate's requirements.

Figure 10: Sovereign ESG impact framework – impact score versus impact momentum score⁴



^{3,4} As of March 2023. For illustrative purposes only. Flexibility to invest in specific issues is defined by the terms of an investment mandate.

INSIGHT'S RESPONSIBLE INVESTMENT AND FIXED INCOME CREDENTIALS

INSIGHT HAS A LONG HISTORY OF RESPONSIBLE INVESTMENT

- Insight was a founding signatory to the PRI in 2006, the world's leading proponent of responsible investment.
- We have been supporters of the Institutional Investors Group on Climate Change (IIGCC) and CDP initiatives for over 15 years. Insight is also a signatory to the Net Zero Asset Managers initiative and UN Global Compact.
- Insight manages ESG strategies including those with best-in-class, climate, positive impact and exclusion objectives and criteria. Alongside the Prime sovereign ESG risk and impact ratings, Insight uses the Prime corporate ESG and climate risk ratings.

RECENT ACCOLADES FOR FIXED INCOME

- Examples include Insight being named Fixed Income Manager of the Year in 2023, and UK Fixed Income Manager of the Year in 2022, at the Professional Pensions UK Pensions Awards⁵.
- In 2023, and in eight of the last 10 years, UK investment consultants have ranked Insight number one for Fixed Income Overall Quality⁶.

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As a founding signatory to the
UN-supported PRI, Insight has a long
history of responsible investment

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⁵ Awards do not constitute a recommendation of Insight or its services. Awards are not wholly indicative of past or future performance. The description and the selection methodologies of awards may be subjective and will vary. The Professional Pensions UK Pensions Awards are annual awards open to advisers, providers and investment managers for the UK pensions industry. Winners are decided by a judging panel based on entrants' submissions, and no fee is paid for consideration. More information is available at <https://ukpensionsawards.com/>.

⁶ Source: Coalition Greenwich.

FREQUENTLY ASKED QUESTIONS

Q: How do we deal with gaps in ratings/scores?

For both the risk and impact ratings, we only include those metrics with at least 70% coverage over the last five years. If a specific country is missing data for a particular metric, we assign this country the average score from those countries that have coverage.

Q: What happens if there is a meaningful ESG event which the data won't incorporate for some time?

We discuss meaningful ESG events or policy changes weekly at meetings of the Sovereign Fixed Income Responsible Investment Implementation Group and use the sovereign ESG flag system to incorporate rapidly developing issues into our analysis at regular meetings and then flag these as leading indicators for further monitoring. This process involves the country specialist knowledge from the global bond and emerging market debt teams as appropriate.

Q: What if the relevant sovereign analyst disagrees with a rating?

In order to maintain the integrity of the quantitative framework, there is no process by which we would change the risk or impact rating. However, with respect to emerging market countries, when there is a material gap between our Country Risk Score (our fundamental country risk assessment comprised of traditional qualitative and quantitative credit metrics) and the ESG rating, the country specialist adds qualitative color to explain this difference within the relevant internal database.



ASSOCIATED INVESTMENT RISKS

ESG

- **Investment type:** The application and overall influence of ESG approaches may differ, potentially materially, across asset classes, geographies, sectors, specific investments or portfolios due to the nature of the specific securities and instruments available, the wide range of ESG factors which may be applied and ESG industry practices applicable in a particular investable universe.
- **Integration:** The integration of ESG factors refers to the inclusion of ESG risk factors alongside financial risk factors in investment analysis and research to judge the fair value of a particular investment and may also include the monitoring and reporting of such risks within a portfolio. Integrating ESG factors in this way will not typically restrict the potential investable universe, but rather aims to ensure that what we believe to be relevant and material ESG risks are taken into account by analysts and/or portfolio managers in their decision-making, alongside other relevant and material financial risks.
- **Ratings:** The use and influence of our ESG ratings in specific investment strategies will vary, potentially significantly, depending on a number of factors including the nature of the asset class and the structure of the investment mandate involved. For an investment portfolio with a financial objective, and without specific ESG or sustainability objectives, a high or low ESG rating may not automatically lead to a buy or sell decision: the rating will be one factor among others that may help a portfolio manager in evaluating potential investments consistently.
- **Engagement activity:** The applicability of Insight firm level ESG engagement activity and the outcomes of this activity relating to buy, hold and sell decisions made within specific investment strategies will vary, potentially significantly, depending on the nature of the asset class and the structure of the investment mandate involved.
- **Reporting:** The ESG approach shown is indicative and there is no guarantee that the specific approach will be applied across the whole portfolio.
Performance/quality: The influence of ESG criteria on the overall risk and return characteristics of a portfolio is likely to vary over time depending on the investment universe, investment strategy and objective and the influence of ESG factors directly applicable on valuations which will vary over time.
- **Costs:** The costs described will have an impact on the amount of the investment and expected returns.
- **Forward looking commitments and related targets:** Where we are required to provide details of forward-looking targets in line with commitments to external organizations, e.g. Net Zero Asset Managers Initiative, these goals are aspirational and defined to the extent that we are able and in accordance with the third party guidance provided. As such we do not guarantee that we will meet them in whole or in part or that the guidance will not evolve over time. Assumptions will vary, but include whether the investable universe evolves to make suitable investments available to us over time and the approval of our clients to allow us to align their assets with goals in the context of the implications for their investments and issues such as their fiduciary duty to beneficiaries.

Insight applies a wide range of customized ESG criteria to mandates which are tailored to reflect individual client requirements. Individual investor experience will vary depending on the investment strategy, investment objectives and the specific ESG criteria applicable to a Fund or portfolio. Please refer to the investment management agreement or offering documents such as the prospectus, Key Investor Information Document (KIID/KID) or the latest Report and Accounts which can be found at www.insightinvestment.com and where applicable information in the following link for mandates in scope of certain EU sustainability regulations <https://www.insightinvestment.com/regulatory-home/sustainability-regulations/>; alternatively, speak to your main point of contact in order to obtain details of specific ESG parameters applicable to your investment.



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The information shown is derived from a representative account deemed to appropriately represent the management styles herein. Each investor's portfolio is individually managed and may vary from the information shown. The mention of a specific security is not a recommendation to buy or sell such security. The specific securities identified are not representative of all the securities purchased, sold or recommended for advisory clients. It should not be assumed that an investment in the securities identified will be profitable. Actual holdings will vary for each client and there is no guarantee that a particular client's account will hold any or all of the securities listed.

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